The Euro and the Agricultural Sector

by

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On January 1, 1999, eleven of the fifteen countries that make up the European Union fixed their exchange rates and adopted a common currency, the euro. The euro will likely affect intra-EU trade, as a common currency will eliminate exchange rate risk and promote investment between euro-zone countries. Most EU consumers will probably not be significantly affected by the euro until 2002, when actual coins and bills are introduced. For agriculture, the previously complex agrimonetary system was abolished so that producers now receive a truly common set of prices and payments throughout the euro-zone as a result of the fixed exchange rates among euro-zone currencies. Agricultural producers outside the euro-zone, while now facing a set of exchange rates that could move against the euro, have a modified agrimonetary system to receive support payments, which means their payments will change as the exchange rate with the euro changes.

Unlike its predecessor, the ECU, the euro is expected to play a larger role in world markets and will probably be used, at least to some extent, as a currency for financial transactions and central bank reserves. Moreover, monetary policy for the euro will be controlled by a European Central Bank, not by individual member countries. If the euro achieves the kind of status and stability normally attributed to the U.S. dollar on world markets, the euro could significantly affect world agricultural trade and on the competitiveness of EU and U.S. farm products.[1]

The introduction of the euro did away with the complexities of the agrimonetary system in the EU. On January 1, 1999, all ECU-denominated prices were transferred into euro-denominated prices on a one-to-one equivalent. For example, the standard butter intervention price of 3282 ECU per ton is now simply 3282 euros per ton in the euro-zone instead of prices that varied by member state according to the agricultural exchange rate (green rates) that differed from official exchange rates. Green rates were abolished, and all agricultural payments are now converted from euros into national currencies (in the euro-zone) using fixed market exchange rates. However, differences between the green rates and the new euro exchange rates caused immediate decreases in the level of support payments and prices in national currency equivalents. For price support payments, these decreases were quite small for euro-zone countries, in the range of 1.1 to 1.9 percent. For direct payments, however, the range of these decreases was much higher, up to almost 14 percent for Italy.[2] The EC agreed to provide at least partial compensation for disparities between payments under the green rate and euro exchange rate systems.

For countries outside the euro-zone, the Commission enacted a system that converted euros into national currencies using the exchange rate on the day before the operative event, usually defined as the day a shipment was delivered or when the product was presented for intervention. For direct payments, exchange rates were originally fixed throughout the entire year using the daily exchange rate on January 1 for crops and on June 1 for livestock, but that has since been amended to monthly adjustments.

The longer-term effects of the euro on agriculture are not as certain. If the euro is stronger than its predecessor, the ECU, this would affect the euro/US dollar exchange rate, as well as rates with other trading partners, and the competitiveness of EU and U.S. farm products. If the strength of the euro causes the euro/US dollar exchange rate to appreciate, U.S. agricultural exports would be relatively cheaper on European and world markets while European consumers would enjoy cheaper imports and European producers would benefit from better terms of trade and lower interest rates.

Many analysts have predicted that the euro will be relatively stronger than the ECU, in part because of the mandate of the European Central Bank to secure price stability, similar to policies of the German Bundesbank before the euro. However, there are many good reasons to believe that the euro will be weaker than expected, an argument backed up by the euro's lackluster performance during the first few months of 1999. If the euro depreciates relative to the U.S. dollar, U.S. exports would be relatively more expensive on European and world markets and EU exports would be less expensive.

The euro may also put pressure on individual EU countries within the euro-zone to constrain domestic spending on agricultural programs. By resigning control over monetary policy to a European Central Bank, countries within the euro-zone cannot increase money supplies to fund government spending. In addition, euro-zone countries have also agreed to limit fiscal spending as part of a stability pact to coordinate economic development.

In summary, it is unclear whether the euro itself will be a significant pressure for EU agricultural reform in the long term. In the short run, however, the euro will usher in a new level of transparency in agricultural prices and payments between member countries within the euro-zone.

[1] According to an OECD paper, T*he Economic Consequences of the Implementation of the Euro for the Agro-food Sector,* OECD, March 1999.

[2] Decreases in direct payments were larger because the green exchange rate used for direct payments was frozen in June 1995.